



United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-281772

February 25, 1999

The Honorable Charles C. Masten
Inspector General
Department of Labor

Subject: Agreed-Upon Procedures: Federal Unemployment Taxes

Dear Mr. Masten:

We have performed the procedures contained in enclosure II to this letter, which we agreed to perform solely to assist your office in ascertaining whether the net federal unemployment taxes (FUTA) collected by the Internal Revenue Service (IRS) for the fiscal year ended September 30, 1998, are supported by the underlying records. As agreed upon with your office, we evaluated fiscal year 1998 FUTA net collection activity. See enclosure I to this letter for a schedule of these amounts (unaudited).

This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants (AICPA). Accordingly, the adequacy of the procedures to meet your objectives is your responsibility and we make no representations in that respect. The procedures we agreed to perform included (1) detailed tests of a sample of FUTA collection and refund transactions and (2) a review of key reconciliations of IRS to Department of the Treasury records. Enclosure II contains the agreed-upon procedures and our results and findings from performing each of the procedures.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the accompanying schedule of FUTA net collections reflected in enclosure I. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We provided a draft of this letter to IRS officials, along with its enclosures, for review and comment. They agreed with the contents of this letter and its enclosures.

We completed the agreed-upon procedures on February 12, 1999. In performing the agreed-upon procedures, we conducted our work in accordance with generally accepted government auditing standards, which incorporate financial audit and attestation standards established by AICPA. These standards also provide guidance when performing and reporting the results of agreed-upon procedures.

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GAO/AIMD-99-66R FUTA Procedures

B-281772

This report is intended for the use of the Office of Inspector General of the Department of Labor. However, this report is a matter of public record and its distribution is not limited. Consequently, copies are available to others upon request. If you have any questions, please call me at (202) 512-3406.

Sincerely yours,

A handwritten signature in cursive script that reads "Gregory D. Kutz". The signature is written in black ink and is positioned above the printed name.

Gregory D. Kutz
Associate Director, Governmentwide Accounting
and Financial Management Issues

Enclosures

FEDERAL UNEMPLOYMENT TAX ("FUTA")
SCHEDULE OF COLLECTIONS, REFUNDS, AND NET COLLECTIONS
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1998
(Unaudited)

| | |
|-----------------|-------------------------|
| Collections | \$ 6,504,793,535 |
| Refunds | <u>\$ 113,147,372</u> |
| Net Collections | <u>\$ 6,391,646,163</u> |

| <u>Agreed-upon procedures</u> | <u>Description of findings and results</u> |
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| (A) General | |
| (1) Trace gross FUTA collections and refunds on the Schedule of Collections, Refunds, and Net Collections (enclosure I) to IRS' fiscal year 1998 audited statement of custodial activity and related footnote disclosures. | (1) The gross FUTA collections and refunds on the Schedule of Collections, Refunds, and Net Collections agreed with IRS' fiscal year 1998 audited statement of custodial activity and related footnote disclosures. |
| (2) Review material ⁸ IRS post-closing adjustments to FUTA collections and refunds to determine if they are adequately supported. | (2) There were no material post-closing adjustments to FUTA collections and refunds. |
| (3) Compare fiscal year 1998 net FUTA collections per IRS' audited statement of custodial activity and related footnote disclosures to drafts of (a) Treasury's Bureau of Public Debt (BPD) financial statements for the Unemployment Trust Fund (UTF), and (b) the Department of Labor's (DOL) consolidated financial statements. Obtain explanations/support for material variances. | (3) There were no material variances between net FUTA collections per IRS' audited statement of custodial activity and related footnote disclosures and drafts of (a) BPD's financial statements for UTF, and (b) DOL's consolidated financial statements. |
| (B) Sampling | |
| (1) Obtain data from IRS reflecting the first 9 months of fiscal year 1998 FUTA collections and refunds posted to the master file. Determine if FUTA collections and refund data per the master file materially reconcile to the general ledger. | (1) FUTA collections and refund data for the first 9 months of fiscal year 1998 per the IRS master file materially reconciled with IRS' general ledger. |
| (2) Use Dollar Unit Sampling to extract a sample of combined FUTA collection and refund transactions from the master file for the first 9 months of fiscal year 1998, using a confidence level of 80 | (2) Use of Dollar Unit Sampling with a confidence level of 80 percent, a test materiality of \$230 million, and an expected aggregate error amount of \$115 million resulted in a sample of 120 |

⁸As agreed upon with the Department of Labor's Office of Inspector General, test materiality for the agreed-upon procedures associated with FUTA transactions was \$230 million.

| <u>Agreed-upon procedures</u> | <u>Description of findings and results</u> |
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| percent, a test materiality of \$230 million, and an expected aggregate error amount of \$115 million. | transactions for the first 9 months of fiscal year 1998. Of this total, 117 transactions represented collections and 3 transactions represented refunds. |
| (C) Collections testing | |
| (1) Trace sampled FUTA tax collection transactions to source documents as follows: | |
| <p>(a) – Determine if collection amounts are accurately recorded by tracing collection transaction amounts from IRS' master files to deposit confirmation documents (e.g., federal tax deposit coupons).</p> <p>– Determine if amounts were posted to the appropriate period by reviewing the date on source documents.</p> <p>– Determine whether the transactions were properly categorized as FUTA receipts by reviewing source documentation maintained in IRS' files (e.g., tax returns).</p> <p>– Perform bank confirmations for FUTA transactions paid via the Electronic Federal Tax Payment System (EFTPS)^b to determine whether the recorded transactions are valid and reflect the proper amounts, are applied to the proper tax period, and are properly categorized as FUTA receipts.</p> | <p>(a) – Based on supporting documentation, collection amounts were accurately recorded, posted to the appropriate period, and recorded in the correct tax class for 116 of the 117 sampled FUTA collection transactions. The remaining sample item, with a collection amount of \$3,802.64, was a reclassification of a prior year's erroneous posting of a FUTA receipt into corporate tax receipts, which resulted in an understatement of FUTA receipts in fiscal year 1997 by \$3,802.64 and overstatement by that same amount in fiscal year 1998. The projected net most likely error is about \$50 million with a net upper error limit of about \$148 million at the 80 percent confidence level for the first 9 months of fiscal year 1998.</p> <p>– Seventy-five of the 117 sampled FUTA receipt transactions were paid via EFTPS. Of these 75, the bank confirmation showed six transactions where there was a difference between bank records and IRS records related to posting the receipt to the proper tax period. However, a subsequent comparison of tax returns to IRS master file data</p> |

^bEFTPS is a system for initiating tax payments electronically.

| <u>Agreed-upon procedures</u> | <u>Description of findings and results</u> |
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| | indicated that IRS' information was correct. |
| (b) Recalculate each tax return to verify mathematical accuracy. | (b) The tax returns associated with 116 of the 117 FUTA collection sampled transactions were mathematically correct. On the tax return associated with the remaining sample item, the taxpayer made a mathematical error that resulted in an understatement of the taxpayer's assessed FUTA tax liability by \$6,200. |
| (D) Refunds testing | |
| (1) Trace sampled FUTA refund transaction amounts to source documents as follows: | |
| (a) – Determine if refund amounts are accurately recorded by tracing the refund transaction amounts from IRS' master files to Treasury's Financial Management Service (FMS) disbursement confirmation documents. – Determine if amounts were posted to the appropriate period by reviewing the date on the source documents. – Determine whether the transactions were properly recorded as FUTA refunds by reviewing source documentation maintained in IRS' files (e.g., tax returns). | (a) Based on supporting documentation, refund amounts were accurately recorded, posted to the appropriate period, and recorded in the correct tax class for all three of the sampled FUTA refund transactions. |
| (b) Recalculate each tax return to verify mathematical accuracy. | (b) The tax returns for all three FUTA refund transactions were mathematically correct. |
| (c) For FUTA tax returns, determine whether the taxpayer provided a written explanation for exempt payments, and whether the | (c) For all three FUTA refund transactions, the taxpayer did not claim any exempt wage payments that would have required an explanation. |

| <u>Agreed-upon procedures</u> | <u>Description of findings and results</u> |
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| explanation meets IRS' criteria for FUTA exempt wage payments. | |
| (d) Check to see that IRS did not issue refunds after the Refund Statute Expiration Date. | (d) For all three sampled FUTA refund transactions, IRS issued the refund in advance of the Refund Statute Expiration Date. |
| (e) For manual refunds, check to see that the appropriate supporting documentation is attached and that individuals who approved manual refunds were authorized to do so. | (e) None of the three sampled FUTA refund transactions were manual refunds. |
| (E) Analytical tests | |
| (1) Perform a predictive test on FUTA revenue collection and refund data for the final 3 months of the fiscal year to determine if reported fiscal year 1998 revenue collections and refunds appear consistent and reasonable. Project the expected fourth quarter FUTA revenue collection and refund amounts for fiscal year 1998, based on fiscal year 1997 quarterly amounts, and compare the projection to actual revenue collections and refunds. If a material variance exists, discuss with IRS to obtain an explanation/support. | (1) The predicted fourth quarter FUTA revenue collection and refund amounts for fiscal year 1998 did not materially vary from the actual amount of revenue collections and refunds during this period. |
| (2) Perform an analytical test comparing reported FUTA net revenue collections as of the interim test period (June 30, 1998) and as of the end of the fiscal year (September 30, 1998) to the respective prior periods. If a material variance exists, discuss with Treasury's Office of Tax Analysis (OTA) to obtain an explanation/support. | (2) FUTA net revenue collections as of the interim test period and the fiscal year ended September 30, 1998, materially increased from the respective prior periods. We were able to obtain an adequate explanation/support for the increases in FUTA net revenue collections. |
| (F) Other FUTA tests | |
| (1) For each of the 12 months in fiscal year 1998, obtain and review supporting documentation for monthly revenue reclassification adjustments transmitted by IRS to Treasury's FMS. Check to see | (1) Documentation supported the monthly FUTA reclassification adjustment amount transmitted to Treasury's FMS for all 12 months of fiscal year 1998. |

| <u>Agreed-upon procedures</u> | <u>Description of findings and results</u> |
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| that the supporting documentation agrees with the reclassification adjustment transmitted to FMS. | |
| (2) For each of the 12 months in fiscal year 1998, obtain and review supporting documentation for the monthly entry of FUTA refund data onto the Government Online Accounting Link System (GOALS) to charge back the Unemployment Trust Fund account for FUTA tax refunds issued. Check to see that the supporting documentation agrees with the monthly entries reported on GOALS. | (2) Documentation supported the monthly FUTA refund amount entered on GOALS to charge the Unemployment Trust Fund for FUTA tax refunds issued for all 12 months of fiscal year 1998. |
| (G) Other tests performed as part of the IRS financial statement audit | |
| (1) Perform detailed tests on samples of IRS' collection and refund transactions for the first 9 months of fiscal year 1998 to determine if they contain any FUTA transactions that were misclassified. | (1) Detailed testing of a total of 522 collection and refund sample transactions did not reveal any instances of misclassifications related to FUTA. |
| (2) Review selected IRS service centers' monthly Treasury 224 reconciliations to determine if IRS-reported FUTA revenue collections were properly classified and reconciled to Treasury FMS records. For refunds, review selected IRS service centers' monthly Treasury 224 reconciliations to determine if IRS-reported total refunds (all tax classes) materially reconciled to Treasury FMS records. ^c | (2) <ul style="list-style-type: none"> - FUTA revenue collections reported by the selected IRS service centers via the monthly Treasury 224 reconciliation process were properly classified and materially agreed with Treasury FMS records. - Total refunds reported by the selected IRS service centers via the monthly Treasury 224 reconciliation process materially agreed with Treasury FMS records. |

^cIRS maintains records of refund balances by tax class in its master file, and reports this information monthly to Treasury via the SF-224. Treasury provides IRS with a Statement of Differences (TFS-6652), which reports differences between total refunds reported by IRS on the SF-224 and the total refunds per Treasury records.

| <p align="center"><u>Agreed-upon procedures</u></p> | <p align="center"><u>Description of findings and results</u></p> |
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| <p>(3) Perform a proof of cash for fiscal year 1998, to check to see that year-end FUTA collection balances per the general ledger materially agree to IRS' master files and to Treasury records. For refunds, perform a comparison of total refund balances between the master file, the general ledger, and Treasury records. Also, compare FUTA refunds per the master file to the general ledger.</p> | <p>(3)</p> <ul style="list-style-type: none"> - Fiscal year-end FUTA collection balances per IRS' general ledger materially agreed to IRS' master files and to Treasury records. - Fiscal year-end total refund balances per IRS' general ledger materially agreed to the master file and to Treasury records. - Fiscal year-end FUTA refund balances per IRS' general ledger materially agreed to the master file. |

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